JM Financial Group

Issue 64: August 2020

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st August 2020)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**+10.35**	**+21.48**	**+21.42**	**+78.44**	**+185.02**	**+18.51**
Small Ords Accumulation Index	+7.24	+6.61	+2.07	+26.03	+58.90	+7.80
Outperformance	**+3.11**	**+14.87**	**+19.35**	**+52.41**	**+126.12**	**+10.71**

Although the JMFG Australian Equities Strategy is generally representative of client portfolios, Individual performance may differ from the results above. These differences can arise due to various issues, some of which may relate to initial timing of investments and cash inflows and outflows. Performance is calculated on a TWRR basis – and is after management fees, taxes (excl imp. credit benefits) and any paid or accrued performance fees. Strategy Inception for Performance Data is July 1st, 2014.

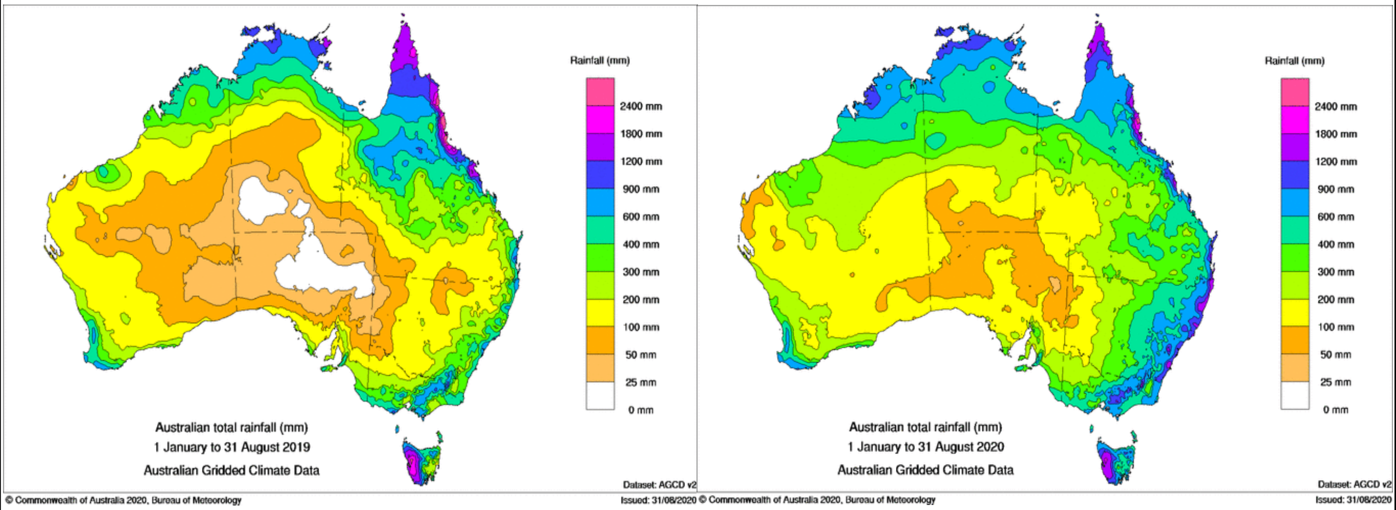
***Month in Review –** A review of events that influenced the share market and portfolio in August*

The JMFG Small Companies Strategy continued a run of strong months, rising 10.35% in August, against its benchmark which increased 7.24%, resulting in outperformance for the month of 3.11%. The Strategy outperformed its benchmark by 14.87% for the rolling quarter and 19.35% for the rolling 12-month period. The annualised return since inception, over six years ago, increased from around 16.9% p.a. at the end of July 2020 to over 18.5%, following the result of the last month, and compares to the annualised benchmark return of 7.8% p.a. The strong result for the month was pleasing in that it was not dominated by a small handful of stocks, with 11 stocks in the portfolio rising in excess of 20% over the month.

For a second month running there was a wide divergence of returns across sectors, with the strongest performers in the broader market including I.T. +15.5%, Consumer Discretionary +8.7%, Property Trusts +7.9% and Industrials +4.6%. The weakest sectors included Utilities -4.8%, Telecommunications -3.8% (reversing last month gains), Consumer Staples -0.4% and Materials +1.2%. The ASX Small Ordinaries index, +7.2%, was substantially stronger than the broader market which rose 2.8%. The ASX Small Ordinaries benefited from the strong rally in the I.T segment where there is a much larger relative representation than in the ASX 200 index.

Trading was active through August, a function of several large price movements. We moderated positions across Sezzle, Codan, Class Ltd, Breville Group and Infomedia, all following strong price rises. We added to positions in Bapcor, Medical Developments and Beach Petroleum, the latter two on price weakness, whilst Bapcor became a more meaningful portfolio holding. We exited Kathmandu following a solid rally from its point of purchase and we introduced two new stocks to the portfolio, Megaport early in the month and Costa Group late in the month. Our cash exposure dropped marginally over the month from 16% toward 15%. Our best performing stocks over the month included Sezzle +51%, People Infrastructure +42%, Tesserent +39%, Class Ltd +37% and Nearmap +35%. Our worst performers included Saracen Mineral Holdings -13%, Bravura Solutions -12%, Infomedia -9% and Imdex -6%.

Chart of the Month – Australian Total Rainfall and Water Security



Through 2017-2019 the Murray-Darling Basin and Australia generally experienced one of the worst droughts on record for the region with consistently high temperatures and greatly reduced rainfall through the region. However, the first 8 months of 2020 have tracked much better than the three prior years, providing Australia's primary irrigation region with much needed rainfall to improve the water security of the region. The diagrams above show the greatly improved rainfall conditions in 2020 compared to the prior corresponding period in 2019. This increased rainfall also gives growers access to higher quality water which can significantly improve crop yields.

Best & Worst Performers for August 2020

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Sezzle – SZL	Saracen Mineral – SAR	Pointsbet – PBH	Whitehaven Coal – WHC
People Infrastructure – PPE	Bravura Solutions – BVS	Corporate Travel – CTD	Australian Ethical – AEF
Tesserent – TNT	Infomedia – IFM	Zip Co – Z1P	Ioneer – INR

Hits & Misses – *A summation of the top hits and misses for the month of July*

Sezzle (SZL) – up 51% for the month. Following on from July where it provided a very strong trading update and capital raising, Sezzle along with several buy now pay later stocks continued to rally through August, to levels that appear to be a bit overheated. We halved our position on this strength at month end.

Pointsbet (PBH) – up 118% for the month (Not held). PBH announced late in the month that it entered a five year media partnership with NBC Universal, a subsidiary of Comcast Corporation, to become the official sports betting partner of NBC Sports. The arrangement will provide access to NBC's national and regional television and digital assets.

Saracen Mineral (SAR) – down 13% for the month. The US$ gold price was flat over the month but with a strengthening A$, the A$ gold price fell 3% leading to a sector decline of 7.7%.

Whitehaven Coal (WHC) – down 33% for the month (Not held). Whitehaven reported a FY20 result that disappointed the market with sales 30% lower, EBITDA around 70% lower and underlying profit 95% lower than the prior year.

Due Diligence – *A closer look at a stock of interest*

Costa Group (CGC)

Costa Group is a diversified fresh produce company with operations across Australia as well as internationally in China and Morocco, with multiple sales channels both domestically and into export markets. Costa operates a vertically integrated business model that achieves competitive advantage whilst managing agricultural risk through a combination of diversification, scale, market share, and protected cropping, and combining this with intellectual property and technology to create superior product genetics and efficient production techniques. Its year round production helps to smooth earnings and mitigate against seasonal and regional climatic variations.

Nonetheless, there still can be fluctuations from period to period and Costa Group recently experienced a confluence of factors that adversely affected earnings and cashflow over the past 12-18 months. A combination of drought and generally low water table levels, along with delays across several new facilities constructed domestically and internationally, resulted in earnings declines. In addition, the Covid-19 pandemic also had an impact on costs and disrupted distribution into certain markets. The continued recovery from drought in Australia in the major catchments that Costa Group operates means that it now has high water security across all of its locations. In addition, the significant investment made in new facilities over the past two years has begun to see improved volume and yields with tomato and berry crops recovering to full yield, and operations in China and Morocco now generating strong earnings contributions.

Costa's range of fresh produce includes tomatoes, a range of citrus, avocado, banana, mushrooms, grapes, raspberries, blackberries, blueberries, and strawberries.

In total Costa Group has around 5,300 planted hectares with citrus comprising over 2,400 hectares. High value berry crops account for around 1,300 hectares including 237 hectares in China and 345 hectares in Morocco. Avocado accounts for around 750 hectares and banana over 275 hectares. Whilst tomatoes only account for 30 hectares, it is a high value crop and the entire crop is in glasshouses with, therefore, a very high yield year-round. Around 80% of revenue in 1H20 came from the Australian operations with the split by produce type around 31% citrus, 22% mushroom, 19% berry, 14% avocado/banana and 14% tomato.

Costa Group was recently added to the portfolio and, at the time of purchase, was trading at around 16-17x after tax earnings. Given its ongoing domestic and global expansion potential and the current status of its water security, we felt that Costa Group provided a sensible diversification to the portfolio, particularly given its potential to provide returns uncorrelated to the economy in general.